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From:
Sent: Friday, July 01, 2011 4:20:14 PM
To:
Cc:
Subject: RE: LexisNexis(R) 1.263A-8 (2827:293080340)

I am attaching a copy of a memorandum that discusses similar legal issues in the context of a different type of property. Although it was prepared some time ago, I believe it still may contain some useful material.

ATTACHMENT 1

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

MEMORANDUM FOR Chief Compliance Officer 4300 MSRO
Midstates Region
Attn:

FROM: Assistant Chief Counsel (Income Tax & Accounting)
By: _____
[Assistant to the Branch Chief]

SUBJECT: Treatment of Offshore Platforms under 263A(f)

This memorandum is in reply to your request dated May 1, 1998, for technical assistance with respect to the application of §263A(f) of the Internal Revenue Code to offshore platforms.

ISSUES:

1. Are offshore jacket-type platforms “real property“ for purposes of the interest capitalization provisions of § 263A(f)?

2. When does the production period for jacket-type platforms begin for purposes of the interest capitalization provisions of § 263A(f)?

CONCLUSIONS:

1. Offshore jacket-type platforms are “real property“ for purposes of § 263A(f).

2. The production period for a self-produced jacket-type platform begins when actual physical construction on the platform is first performed. The production period for a jacket-type platform produced under contract begins for the customer when actual physical construction on the platform is first performed, whether by the contractor or the customer, and begins for the contractor when the contractor first performs actual physical construction on the platform.

SUMMARY ANALYSIS:

ISSUE 1: Section 1.263A-8(c)(1) of the Income Tax Regulations defines "real property" to include inherently permanent structures, which in turn are defined by § 1.263A-8(c)(3) to include property that is affixed to real property and will ordinarily remain thus affixed for an indefinite period. Jacket-type platforms are strongly and permanently affixed to the ocean floor. They are designed and constructed to remain at the site where they are installed for an indefinite period of time. Accordingly, jacket-type platforms qualify as inherently permanent structures under § 1.263A-8(c)(3) and thus constitute real property for purposes of § 263A(f).

Additionally, § 1.263A-8(c)(3) provides that inherently permanent structures include any property that qualifies as an inherently permanent structure under the principles of former § 48(a)(1)(B) and § 1.48-1(d). Under such principles, an item of property was an inherently permanent structure if the overall facts and circumstances indicated that the property was permanently installed at its site. Jacket-type platforms have numerous characteristics reflecting such permanence. They are designed to suit a particular site, and are durably constructed and solidly installed to remain at that site indefinitely. Removing the platform from the site is expensive and time consuming, and the platform normally cannot be reused at another site. Jacket-type platforms are therefor inherently permanent structures for purposes of former § 48, and thereby qualify as inherently permanent structures under § 263A(f) as well.

Under § 1.263A-8(c)(4), however, property that otherwise qualifies as an inherently permanent structure is not real property for purposes of § 263A(f) if it is property in the nature of machinery or equipment. For purposes of this rule, a jacket-type platform is not property in the nature of machinery or equipment because it performs no mechanical functions in its own right, even though it supports drilling machinery and is necessary for its operation.

ISSUE 2: The production period for jacket-type platforms is determined under the rules of § 1.263A-12(c)(2) applicable to real property. The production period for a self-produced jacket-type platform begins when any physical production activity is performed with respect to the platform. The production period for a jacket-type platform produced under contract begins for the customer when any physical production activity is performed with respect to the platform, whether by the contractor or the customer, and begins for the contractor when the contractor first performs actual physical construction on the platform. Section 1.263A-12(f) specifically provides that soil testing, preparing architectural blueprints or models, obtaining building permits, and incidental repairs are not considered to be physical production activities.

FACTS:

In order to produce oil and gas from offshore reservoirs, especially in areas where violent weather occurs, oil and gas producers must build massive permanent

offshore platforms. The platforms and related development wells may cost hundreds of millions of dollars. In order to economically justify the huge investment involved, a field must generally contain hundreds of millions of proved equivalent barrels of oil.

The drilling of a single well will ordinarily not substantiate the existence of an economic quantity of reserves. Instead, an oil company will drill several exploratory wells to assess the probability that adequate reserves exist to justify development. These wells will also be used to determine the precise location for constructing a permanent platform to be used for drilling development wells and installing production facilities to produce oil and gas in commercial quantities. Most exploratory wells are drilled from movable drilling ships known as mobile offshore drilling units (MODUs). The construction of the platform will not begin until the exploratory wells confirm the existence of commercial quantities of oil and gas.

There are two general categories of platforms in use around the world today, rigid platforms and compliant platforms. Types of rigid platforms include the steel jacket platform, the concrete gravity platform, and the caisson-type platform. Types of compliant platforms include the guyed tower, the tension leg platform, and the spar.

Rigid platforms are the oldest design in offshore platforms. They are most often utilized in development drilling in water depths that do not exceed about 1,000 feet. In deeper waters, the use of rigid platforms is not practical, so complaint platforms, which are lighter and contain fewer steel parts than rigid platforms, are utilized instead.

The most common type of offshore platform is a rigid structure referred to as a “steel jacket platform“ or “jacket-type platform.“ As its name implies, this platform is made primarily of steel and is designed to withstand severe environmental conditions, such as hurricanes and strong winds, for an indefinite period. It consists of three basic parts. The *deck*, or *topsides*, is of a series of platforms that provide space and support for drilling equipment and personnel. The *jacket*, or *steel jacket*, is a tower-like structure fabricated from tubular steel members. Its bottom rests on the sea floor and its top, where the deck is attached, lies well above the waterline. Finally, the *anchoring system* stabilizes and anchors the platform to a fixed site by means of pilings driven through the legs of the jacket and into the seabed.

The jacket is usually constructed on land, placed onto a barge, and towed out to the site for installation. Several of the tubular members of the jacket are sealed airtight so that the jacket floats when launched into the water. Then, large barge-mounted cranes are rigged to the jacket to stabilize it and raise it to an upright position. The tubular legs are then flooded with water so that they sink to the bottom of the ocean. When the legs come to rest on the sea floor, piles are driven through the legs and into the sea bottom to pin the jacket permanently to the site. The piles are welded to the legs at the top of the jacket, and grout is sometimes injected in the space between the pilings and the inside of the tubular legs. Finally, the topside is placed on the top of the jacket, and the unit is readied for drilling and production operations.

Once oil production has ceased, the platform is generally removed and the ocean bed is restored to its original condition. The *Geneva Convention of the High Seas* and the *OCS Land Act* specify that "any installations which are abandoned or disused must be entirely removed." Government authorities occasionally allow platforms to be removed from the seabed, towed to designated areas outside of shipping lanes, and sunk to form artificial reefs. In rare instances, operators may be allowed to cut off the tops of platforms to a certain water depth and leave the substructures in place. In most cases, however, the structure is towed to land and is cut up, recycled as scrap, or disposed of as refuse.

For a variety of reasons, the offshore oil and gas industry traditionally does not reuse steel jacket platforms. A jacket-type platform and its three main components are designed as an integrated unit appropriate for a particular well site, taking into consideration the condition of the seabed, storm ratings, water depths, tides, wave forces, well spacing and other factors affecting the number and depth of wells desired and the size and configuration of the components. Once fabricated, neither the platform nor its major components are ordinarily reusable at a different well site without substantial and costly modifications.

Additionally, the process of removing a platform from a site often damages it so extensively that it cannot be reused without an economically prohibitive amount of refurbishment. Many older platforms no longer comply with current environmental and safety regulations. Older components may not be compatible with current designs and practices. Because of all these difficulties, many engineers and contractors prefer to design and construct a new platform for each new site, and are reluctant to undertake assignments to retrofit old platforms.

LAW AND ANALYSIS:

ISSUE 1: Are offshore jacket-type platforms "real property" for purposes of the interest capitalization provisions of section 263A(f)?

Section 263A(f) requires a taxpayer producing certain types of property to capitalize interest as a cost of production. The property subject to such interest capitalization includes (i) real property and (ii) certain tangible personal property. To be subject to interest capitalization, tangible personal property must have (a) a § 168 class life of 20 years or more and be intended for use by the taxpayer or a related party; (b) an estimated production period exceeding 2 years; or (c) an estimated production period exceeding 1 year and a cost exceeding $1,000,000. § 1.263A-8(b)(1).

Accordingly, if jacket-type platforms constitute "real property" under § 263A(f), they are subject to interest capitalization without regard to their class life, cost, or production period. If these platforms do not constitute real property, they are subject to interest capitalization only if they meet the threshold criteria applicable to tangible personal property. The § 168 class life of offshore platforms is only 14 years. Rev. Proc. 87-56, Asset Class 13.2. Thus, a jacket-type platform would be subject to interest

capitalization as tangible personal property only if its estimated production period exceeded 2 years or its estimated production period exceeded one year and its cost exceeded $1,000,000.

The term "real property" as used in § 263A(f) is not defined by statute. The regulatory definition of the term is set forth in § 1.263A-8(c)(1), which provides in part that real property "includes land, unsevered natural products of land, buildings, and inherently permanent structures." Section 1.263A-8(c)(1) further provides that real property includes the structural components of both buildings and inherently permanent structures, such as walls, partitions, doors, wiring, plumbing, central air conditioning and heating systems, pipes and ducts, elevators, and escalators, and other similar property.

Jacket-type platforms are not land, natural products of land, or buildings. Accordingly, these platforms constitute real property under § 263A(f) only if they are inherently permanent structures under § 1.263A-8(c)(1).

The term "inherently permanent structures" is defined in § 1.263A-8(c)(3) to include "property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time." This definition is illustrated by numerous examples, including swimming pools, paved parking areas, telephone poles, broadcasting towers, oil and gas pipelines, derricks, and storage equipment.

Section 1.263A-8(c)(3) further provides that inherently permanent structures include any property that "constitutes other tangible property under the principles of former section 48(a)(1)(B) and § 1.48-1(d)." As discussed in greater detail below, "other tangible property" under former § 48 means property classified as inherently permanent structures for purposes of the former investment tax credit (ITC) and structural components of such property. Thus, "inherently permanent structures" under § 1.263A-8(c)(3) include property that qualified as inherently permanent structures, or structural components thereof, under statutes and regulations applicable to the former ITC.

The definition of real property for purposes of § 263A(f) is subject to one additional qualification potentially relevant to jacket-type platforms. Section 1.263A-8(c)(4) provides that a structure that is "property in the nature of machinery or is essentially an item of machinery or equipment" is not an inherently permanent structure and is thus not real property for purposes of § 263A(f). Thus, if jacket-type platforms are property in the nature of machinery or equipment, they are not real property for purposes of § 263A(f), even if they would otherwise qualify as such because they were affixed to land for an indefinite period or because they were "other tangible property" under former § 48(a)(1)(B) and § 1.48-1(d).

1. Affixation to real property for indefinite period under § 1.263A-8(c)(3).

No cases or rulings have construed whether an item is "property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time" as set forth in the definition of an inherently permanent structure in § 1.263A-8(c)(3).

Guidance regarding the application of this definition is limited to the examples provided in the regulation itself.

Jacket-type platforms are "affixed" to land at their drilling sites within any ordinary meaning of this term. The platform is held in place by driving pilings through the legs of the jacket into the sea floor. Pilings are welded to the platform at the top of the jacket legs, and, in some cases, grout (cement without aggregates) is pumped into the annulus (space) between the piling and the inside of the leg.

The affixation of a jacket-type platform must be strong enough to withstand ocean currents, strong winds and other severe environmental conditions at the site. Further, severing such platforms from the sea bed is a time-consuming and expensive project, requiring expert engineering and specialized equipment. Cutting piles most commonly requires explosives, but machinery for abrasive and mechanical cutting is also available.

In sum, jacket-type platforms are very strongly affixed to land. They are certainly very comparable in this respect to many of the examples in § 1.263A-8(c)(3) of inherently permanent structures, including wharves and docks, fences, inherently permanent outdoor lighting and advertising installations, and broadcasting towers.

Jacket-type platforms are also affixed to land for an "indefinite period of time." Section 1.263A-8(c)(1) furnishes no definition or example of an indefinite period of time, so the phrase must be interpreted according to the common and ordinary meanings of its terms. Construed in this light, affixing property for an indefinite period of time means that the property is affixed without any fixed plan to remove it at a particular date in the future.

By their very nature, jacket-type platforms are installed for indefinite periods of time. Their function is to facilitate the production of oil in commercially feasible quantities. When they can no longer perform this function "either because the well has been exhausted or because further exploitation of the well has become uneconomic" they are ordinarily removed from the site, although some platforms are toppled on site where this is permitted by law. The exact date when the platform will be removed or toppled is neither known nor knowable when it is affixed to the seabed.

A jacket-type platform is installed for an "indefinite period" for purposes of § 1.263A-8(c)(3) even though its useful life is inherently limited and it will be removed at the end of such life. This is illustrated by the examples of inherently permanent structures in § 1.263A-8(c)(3). Like jacket-type platforms, these structures generally remain affixed to real property only for the period during which they remain in operating condition and serve a useful function at their installation sites. An inherently permanent advertising display, for example, remains affixed as long as it is structurally sound enough to display advertisements and advertisers are willing to pay a sufficient rate for its use. Any construction of "indefinite" that would exclude property affixed to land for its useful life in that location would exclude inherently permanent advertising displays

and all the rest of the supplied examples, which demonstrates that such construction is erroneous.

More specifically, the examples in § 1.263A-8(c)(3) include derricks and oil pipelines, which have exactly the same anticipated period of affixation as jacket-type platforms. They remain affixed as long as oil is present at the site of affixation that can be extracted or transported at commercially viable rates. Thereafter, these items are abandoned in place or removed from their sites for salvage, reuse, or disposal, just like jacket-type platforms. If pipelines and derricks are affixed for an indefinite period for purposes of § 1.263A-8(c)(3), then the same must necessarily be true for jacket-type platforms.

In sum, jacket-type platforms qualify as inherently permanent structures under § 1.263A-8(c)(3) because they are affixed to land and ordinarily remain thus affixed for an indefinite period of time.

2. "Inherently permanent structures" under former § 48(a)(1)(B) and § 1.48-1.

Former § 48(a) defines "section 38 property," which was eligible for the former investment tax credit (ITC). Generally, section 38 property includes (i) tangible personal property, and (ii) certain other categories of tangible property specified within former § 48. The largest of these categories is "other tangible property" as defined by former § 48(a)(1)(B) and § 1.48-1(d), which includes a wide range of property used in certain manufacturing, production, extraction, research and storage activities.

Former § 48 contains no definition of "tangible personal property." The legislative history of the section indicates, however, that "tangible personal property" includes "any tangible property except land, and improvements thereto, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures)." Legislative history further establishes that tangible personal property is not intended to be narrowly defined, and is not controlled by state law property concepts. H. Rept. No., 1447, 87th Cong., 2nd Sess., 11-12 (1962), 1962-3 CB 405, 515-516; S. Rept. No. 1881, 87th Cong., 2d Sess., 16-17 (1962), 1962-3 C.B. 707, 858.

The regulations promulgated under former § 48 closely track the legislative history of the statute. "Tangible personal property" is defined in § 1.48-1(c) to include "any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures)." Section 1.48-1(c) further provides that an item of property may be tangible personal property even though it qualifies as a fixture under local law, while another item of property may be other tangible property even though it is classified as personal property under local law.

"Other tangible property" under former § 48(a)(1)(B) is not directly defined by statute or regulation, but its meaning can be determined from context. The term "other" refers to "tangible personal property" in the immediately preceding subparagraph (A).

This indicates that “other tangible property“ potentially includes any tangible property that is excluded from “tangible personal property“ under former § 48(a)(1)(A), namely land, buildings, inherently permanent structures, and structural components of buildings and inherently permanent structures. *See* § 1.48-1(c). Former § 48(a)(1)(B) specifically excludes buildings and their structural components from “other tangible property.“ Land is also excluded because it is not depreciable property. By process of elimination, therefor, “other tangible property“ under former § 48(a)(1)(B) consists of inherently permanent structures and their structural components.

Two important points should be noted with respect to the reference to former § 48 in § 1.263A-8(c)(3). First, the concept of inherently permanent structures under the ITC is similar to, but not necessarily identical with, the concept of inherently permanent structures in § 1.263A-8(c)(3). The ITC definition of inherently permanent structures was developed and construed in light of Congressional intent regarding the ITC, which favored a broad construction of “tangible personal property“ and a correspondingly narrow construction of “other tangible property“ and “inherently permanent structures.“ The legislative history of § 263A(f), by contrast, contains nothing to indicate that Congress intended the broad construction of personal property under the ITC to apply to interest capitalization under § 263A(f). Preamble, T.D. 8584, 1995-1 C.B. 20, 22. Accordingly, the narrow construction given to “other tangible property“ and “inherently permanent structures“ under the ITC is not appropriate to the interpretation of inherently permanent structures under § 1.263A-8(c)(3).

Second, the definition of inherently permanent structures in § 1.263A-8(c)(3) utilizes “other tangible property“ under former § 48 merely as a nonexclusive example of the defined term. Accordingly, a item of property may be an inherently permanent structure for purposes of § 1.263A-8(c)(3) even though it would not have been an inherently permanent structure for purposes of the ITC and therefor would not have been “other tangible property“ under former § 48 and § 1.48-1(d).

Several implicit examples of “other tangible property“ are contained within the regulations under former § 48. Swimming pools, paved parking areas, wharves, docks, bridges, and fences are listed in § 1.48-1(c) as examples of things that are not tangible personal property and therefore qualify as “other tangible property.“ In addition, the definition of “integral part“ in § 1.48-1(d)(4) gives these specific examples of “other tangible property“ that are normally used as an integral part of qualified activities: blast furnaces; oil and gas pipelines; railroad tracks and signals; telephone poles; broadcasting towers; oil derricks; and fences used to confine livestock.

Numerous cases and rulings have considered whether specific items of tangible property were “tangible personal property“ or “other tangible property“ within the meaning of former § 48. These authorities do not identify any single factor that is dispositive of this issue; rather, they examine the overall facts and circumstances of the property at issue in light of number of different relevant factors. These factors are collected and enumerated in the leading case of Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664 (1975)*, acq.* 1982-2 C.B. 2.

The United States Tax Court (Tax Court) begins its analysis in Whiteco by noting that decided cases have followed legislative intent and § 1.48-1(c) in holding that affixation to land does not per se exclude property from the category of "tangible personal property" for purposes of former § 48. LaCroix v. Commissioner, 61 T.C. 471, 488 (1974); Estate of Morgan v. Commissioner, 52 T.C. 478, 483 (1969), *aff'd per curium* 448 F.2d 1397 (9th Cir. 1971). The Tax Court then identifies 6 major factors previously considered by courts in determining whether an item of property was an "inherently permanent structure" for purposes of former section 48:

(1) Is the property capable of being moved, and has it in fact been moved?

(2) Is the property designed or constructed to remain permanently in place?

(3) Are there circumstances which tend to show the expected or intended length of affixation, i.e., are there circumstances which show that the property may or will have to be moved?

(4) How substantial a job is removal of the property and how time-consuming is it?

(5) How much damage will the property sustain upon its removal?

(6) What is the manner of affixation of the property to the land?

The factors listed in Whiteco have been cited and accepted in numerous subsequent cases and rulings. *See, e.g.,* McManus v. United States, 863 F.2d 491, 498 (7th Cir.1988); Munford, Inc. v. United States, 849 F.2d 1398, 1405 n. 5 (11th Cir.1988). They are an established part of the principles of former § 48(a)(1)(B) and § 1.48-1(d) with respect to "other tangible property." As such, they constitute an appropriate and convenient framework for organizing the analysis of how jacket-type platforms should be classified under former § 48. *Cf.* § 1.897-1(b)(3)(C) (Whiteco factors are expressly incorporated into regulations for purpose of determining whether property is an "inherently permanent structure" and thus "real property").

The first Whiteco factor identifies one of the best proofs available that an item is movable in actual practice: whether it has actually been moved in the past. The remaining Whiteco factors focus, in different ways, on the practicalities involved in moving the tested property, such as the time, effort and money expended and the damage incurred to the property.

a. Are jacket-type platforms capable of being moved, and are they in fact moved?

Movability is perhaps the most salient characteristic of tangible personal property, but it is not in itself dispositive of whether an item is an inherently permanent

structure under former § 48. Just as affixation to land does not per se exclude property from the category of "tangible personal property" under former section 48, so the mere ability to relocate a piece of property affixed to land does not per se exclude such property from the category of "inherently permanent structures." Everhart v. Commissioner, 61 T.C. 328, 331 (1973); L. L. Bean, Inc. v. Commissioner, T.C. Memo. 1997-175.

Further, movability is inherently a relative criterion. As the Tax Court has observed, almost any structure made by humans can be disassembled, moved, and reassembled somewhere else, given sufficient time and resources. Mallinckrodt, Inc. v. Commissioner, T.C. Memo. 1984-532; L. L. Bean, Inc. v. Commissioner. Whiteco and subsequent authorities focus on whether, in the light of common sense and everyday experience, the property is movable in a practical sense of the term.

Jacket-type platforms are not readily movable and are typically moved only twice in their lifetimes. The first move occurs when the platform is installed. The jacket and deck components are constructed on shore and are towed to the well site for final assembly and installation. The second move occurs when the platform is decommissioned. The platform is severed from the ocean floor and towed away, sometimes in pieces, for offsite disposal or salvage. No attempt is made to maintain the platform as a functioning unit during this second move, although parts of the platform may be reused.

It is theoretically possible to move a jacket-type platform as a functioning unit from one well site to another. Such moves, however, are difficult and expensive because of the extensive disassembly and renovation required. The anchoring system of the platform is destroyed in the process of severing the platform from the first site, so a new anchoring system must be supplied and the jacket must be reconditioned to accept the second anchoring system at the second site. Towing the platform to the second site would typically require separating the deck from the jacket and reassembling them at the new site. As a result of such difficulties, jacket-type platforms are rarely reused as a whole, and are moved only when they are installed and decommissioned.

The theoretical possibility of moving a jacket-type platform from site to site makes it slightly more mobile than swimming pools and parking lots, which would be destroyed in the moving process. § 1.48-1(c). But jacket-type platforms are similar in mobility to other examples of inherently permanent structures in the former § 48 regulations, such as broadcasting towers, oil derricks and fences, which can be relocated without destruction although this is rarely done. § 1.48-1(d)(4).

In sum, a jacket-type platform is essentially an immobile structure, and is comparable in this respect to many examples of inherently permanent structures under the former § 48 regulations.

b. Are jacket-type platforms designed or constructed to remain permanently in place?

Durable construction is one indication that a structure is expected or intended to be permanent. The advertising signs in Whiteco, by contrast, were designed only to last for the term of the contract between the taxpayer and its advertiser, which averaged 5 years. Whiteco, 65 T.C. at 672.

Jacket-type platforms are designed and constructed to remain in place for an indefinite period. Replacing a worn-out offshore platform at a functioning well is time-consuming and expensive. Offshore operators thus have a strong economic motivation to ensure that a single platform will last over the economic lifetime of the well. The economic lifetime of a well, however, is not known or knowable when the platform is installed. Thus, to maximize returns, the offshore operator constructs platforms to withstand the environmental conditions prevailing at the site for the indefinite future.

Thus, jacket-type platforms are designed and constructed to remain permanently in place.

c. Are there circumstances which tend to show the expected or intended length of affixation, i.e. are there circumstances which show that jacket-type platforms may or will have to be removed?

The third Whiteco factor focuses on the expectations and intentions of the parties regarding how long the structure will remain affixed. Like the other factors, it is a matter of degree. Structures are rarely, if ever, constructed with the reasonable intent and expectation that they will remain in place forever. The permanence of a structure depends instead on the foreseeable situations in which the structure would be removed, the likelihood that such circumstances would occur, and their remoteness in time.

In Whiteco, the taxpayer could foresee numerous circumstances in which it intended or expected to remove the signs from their sites. The signs were erected on leased land and had to be removed if the leases were not renewed or if the landowner chose to develop the land. Advertising contracts, which lasted from 3 to 5 years, might not be renewed. Demand for display advertising could shift from one location to another because of changes in roadways, traffic, or other circumstances. These circumstances were not mere remote possibilities; they can and did occur in the ordinary course of events. Further, they were not remote in time from the installation of the sign. *See also* Alabama Displays, Inc. v. United States, 507 F.2d 844, 849, 205 Ct. Cl. 716 (1974).

The Whiteco opinion cites the contrasting case of LaCroix v. Commissioner, 61 T.C. 471, 487 (1974), in which the principles of former § 48 were applied in determining whether planted citrus trees were tangible personal property under § 179. In the LaCroix opinion, the Tax Court noted that these trees could be dug up and moved to another location, but the taxpayer had no intention or expectation of doing so when they were planted. The removal of the trees was merely a hypothetical possibility.

A jacket-type platform lies somewhere between the signs in Whiteco and Alabama Displays and the trees in LaCroix. Like the signs, a jacket-type platform has an intended and expected time when it will be removed. The platform will remain in place as long as the well is economically productive; after that point, applicable law generally requires that the structure be removed from the site, whether for salvage or disposal. Like the trees, however, the exact date of the removal is indeterminate, and it is generally many years or decades from the initial installation.

Further, unlike the signs, jacket-type platforms are not transferred between sites to accommodate shifting demand. The factors limiting reuse of platforms include:

- the platform no longer has sufficient structural strength due to accumulated fatigue and corrosion;
- the platform does not comply with newer standards and regulations
- the platform is no longer compatible with current designs for topsides and rigs
- there is no oil or gas field in the area that presents a good match for the size and type of the platform;
- no contractor can be found that is willing or technically able to undertake reuse of a platform;
- refurbishment or modification of the platform to allow reuse is not economically feasible;
- no liquid market exists in used platforms, or regulations discourage such marketing

Reusing a jacket-type platform requires overcoming one or more of these obstacles. As a result, jacket-type platforms are reused only occasionally, and most existing platforms were installed with the expectation that they would not be reused.

In sum, circumstances show that a jacket-type platform will be removed from its installation site at some point in the future. However, that point is indeterminate and is usually many years or decades after installation. Further, jacket-type platforms are not readily or frequently moved; they are generally moved only when their useful lives have been exhausted.

d. How substantial a job is removal of jacket-type platforms and how time-consuming is it? Are such platforms "readily removable"?

Property is inherently permanent to the extent that it cannot be easily relocated as desired. The advertising signs in Whiteco, for example, were not inherently permanent because, in part, they could be completely removed within two hours and without great expense. In Estate of Morgan v. Commissioner, 52 T.C. 478 (1969) *aff'd per curiam* 448 F.2d 1397 (9th Cir. 1971), floating docks held in place by chains attached to pilings in the lake bottom were not inherently permanent structures because they could be moved or reconfigured by unclipping the chains. The pilings, however,

were permanent because they were buried in the bottom and could only be installed and removed with pile drivers.

Removing a jacket-type platform from a site is a massive undertaking that requires considerable time and money to plan and execute. Experts from various fields must collaborate to create a unique removal plan for each site. Applicable environmental regulations and legal requirements must be ascertained, and necessary permits and approvals must be secured. The engineering requirements of the lift must be carefully analyzed. Specialized equipment, such as derrick barges, must be hired and assembled to execute the plan. To accomplish all of this in a cost-effective manner, operators begin to plan a site decommissioning at least 2 years before the actual removal of the platform.

Costs for decommissioning vary significantly according to the circumstances of each platform, such as the size, location and condition of the platform, water depth and weather conditions at the site, the methods chosen to sever the platform from the seabed, and how far the platform must be towed for disposal. In 1992, the Minerals Management Service estimated the abandonment and clearance costs for platforms on the U.S. Outer Continental Shelf averaged $3.2 million per platform for water depths of 50 feet or less. Costs escalate to $3.9 million for depths up to 200 feet, and up to $9.8 million in water deeper than 400 feet. Approximately 60% of these costs are attributable to platform removal; the remaining 40% consists of items such as plugging and abandonment of well and clearance of debris from the site.

Thus, jacket-type platforms are not “readily removable.“ In fact, they can be removed only with considerable time, effort and expense.

e. How much damage do jacket-type platforms sustain upon removal?

Property is inherently permanent to the extent that it is damaged when it is relocated. The advertising signs in Whiteco, for example, were not inherently permanent, in part, because they could be relocated without sustaining significant damage. Similarly, the floating docks in Estate of Morgan could be removed or reconfigured without damage.

By contrast, jacket-type platforms can sustain considerable damage when they are removed, unless unusual and expensive measures are taken. Pilings are most commonly severed by explosives, which can cause damage to the legs unless the explosion occurs deep below the mudline. It is possible to sever pilings by means of mechanical or abrasive cutting, but such methods are expensive relative to explosives. Further, if the pilings have been secured to the jacket legs with grout, the grout and piling must be removed from the leg before the platform can be reused, which is also an expensive operation.

Because jacket-type platforms have traditionally not been reused, minimizing damage to the platform has not been a high priority in decommissioning. Some

platforms are towed to shore for disposal or salvage as scrap; other are towed to a designated areas for deep-water burial at sea or placement as an artificial reef. In these cases, the platform is often cut into pieces to make it easier to handle. If regulations allow partial abandonment in place, the jacket-type platform is severed in the middle and the top portion is towed away for disposal. If regulations allow abandoning the platform by tipping it at its site, the legs are severed at the required depth by the cheapest available means and the structure is tipped over.

Thus, a jacket-type platform sustains considerable damage upon removal, unless unusual and expensive measures are taken.

f. What is the manner of affixation of jacket-type platforms to the land?

The manner in which property is affixed to land is an indication of whether the property is an inherently permanent structure. Pilings and concrete foundations, for example, are generally considered to be inherently permanent structures, in part because of their firm affixation to the earth. Estate of Morgan v. Commissioner, 52 T.C. 478, 482 (1969); Roberts v. Commissioner, 60 T.C. 861, 866 (1973); Weirick v. Commissioner, 62 T.C. 446, 451 (1974); Marineland of the Pacific v. Commissioner, T.C. Memo. 1975-288; Standard Oil (Indiana) v. Commissioner, 77 T.C. 349, 364-366 (1981).

Property attached to pilings or concrete foundations may be considered to be an inherently permanent structure if it is firmly affixed to, or not readily removable from, the pilings or foundation. Thus, in Roberts, Weirick and Marineland of the Pacific, towers for ski lifts and amusement rides were treated as inherently permanent structures, in part, because of their connection to their foundations. In some instances, the towers were actually sunk into, or welded onto, the foundations, and could only be removed by damaging the property; in other cases, the towers were attached with bolts and were removable in theory, but such removal could only be accomplished with great difficulty because of the massive size of the towers.

By contrast, if property can be readily removed from pilings or a foundation, it is generally not an inherently permanent structure. Thus, in Estate of Morgan, *supra*, the floating dock panels attached to the pilings were treated as tangible personal property because they could be easily detached from the pilings by unclipping the chains. Similarly, in Standard Oil (Indiana), sign poles bolted to a concrete foundation were also treated as tangible personal property because, unlike the poles in Roberts, Weirick, and Marineland of the Pacific, they could easily be detached in a few hours.

Jacket-type platforms are affixed at their sites by means of pilings, which are driven through the hollow legs of the platform and into the sea bottom. The force of friction between the earth and the piling along its embedded length holds the piling in place. To strengthen the connection between the platform and the piling, the piling and platform are welded together at the top of the jacket leg. In some installations, grout (cement without aggregate) is forced in the annulus (space) between the outside of the

piling and the inside of the jacket leg to strengthen further the bonds the jacket and the piling. The use of grout is avoided where reuse of the platform is anticipated because of the substantial time and expense involved in removing the grout and pilings before reuse of the platform. Standard Oil Co. (Indiana) v. Commissioner, 77 T.C. 349, 364-366 (1981); Gulf Oil Co. v. Commissioner, 87 T.C. 324, 328-40 (1986); Texaco v. United States, 598 F. Supp. 1165, 1173 (S.D. Tex. 1984).

Both jacket-type platforms and their pilings are affixed to the sea bed in the manner of inherently permanent structures. The pilings are sufficiently strong to hold the massive platform securely in place in spite of winds and tides, and they are installed so permanently that they can only be removed by destroying them. The jacket-type platform, in turn, is securely attached to the pilings by welds and, in some cases, by grout. Detaching the platform is not a simple matter of unfastening connectors or unscrewing bolts as in Morgan and Standard Oil (Indiana).

g. Summary.

The foregoing appraisal of jacket-type platforms in terms of the Whiteco factors establishes that these platforms are inherently permanent structures, and thus "other tangible property," for purposes of former § 48(a)(1)(B) and § 1.48-1(c). The platforms exhibit all of the characteristics of inherently permanent structures: installation for an indefinite period; durable construction; and affixation to the ground in a manner that is not easily reversed and that precludes ready movement.

"Other tangible property" under former § 48(a)(1)(B) and § 1.48-1(c) is listed as an example of inherently permanent structures in § 1.263A-8(c)(3). Accordingly, jacket-type platforms qualify as inherently permanent structures in § 1.263A-8(c)(3) because they are "other tangible property" under former § 48(a)(1)(B) and § 1.48-1(c).

3. Property in the nature of machinery.

Jacket-type platforms do not constitute property in the nature of machinery or equipment for purposes of § 1.263A-8(c)(4) because they are not items of machinery or equipment. Rather, they merely provide support to machines and equipment.

The regulatory definition of "inherently permanent structures" excludes certain types of property with mechanical characteristics. Specifically, § 1.263A-8(c)(4) provides:

> *(4) Machinery--(i) Treatment.* A structure that is property in the nature of machinery or is essentially an item of machinery or equipment is not an inherently permanent structure and is not real property. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a structural component, the property in the nature of machinery is real property.

> "*(ii) Certain factors not determinative.* A structure may be an inherently permanent structure, and not property in the nature of machinery or essentially an item of machinery, even if the structure is necessary to operate or use, supports, or is otherwise associated with, machinery.

The history of this provision provides additional guidance regarding its meaning. The first regulatory definitions of "real property" and "inherently permanent structures" appeared in the proposed regulations issued August 9, 1991. Prop. Reg. §§ 1.263A(f)-1 to 1.263A(f)-9, 56 Fed. Reg. 40815 (1991). The proposed regulations were subsequently replaced by final regulations, effective December 28, 1994, which also contained definitions of these terms. T.D. 8584, 59 Fed. Reg. 67198 (1994).

Although the proposed and final definitions of "real property" [Prop. Treas. Reg. § 1.263A(f)-1(c)(1); Reg. § 1.263A-8(c)(1)] and "inherently permanent structures" [Prop. Treas. Reg. § 1.263A(f)-1(c)(3); Reg. § 1.263A-8(c)(3)] were substantially similar in most respects, they do differ in their treatment of "property in the nature of machinery." Prop. Treas. Reg. § 1.263A(f)-1(c)(1,3); Reg. § 1.263A-8(c)(1, 3). The proposed definition of inherently permanent structures contains this concluding sentence:

> Any property not otherwise described in this paragraph (c)(3) that constitutes other tangible property under the principles of former section 48(a)(1)(B) and § 1.48-1(d) *(and that is not property in the nature of machinery under § 1.48-1(c))* is treated for purposes of this section as an inherently permanent structure. (Emphasis added.)

The definition of inherently permanent structures in the final regulations contains this same concluding sentence but omits the above-highlighted parenthetical reference to § 1.48-1(c). In addition, the final regulations add a new paragraph (c)(4) to § 1.263A-8, which has no counterpart in the proposed regulations.

The preamble to the final regulations explains that these changes were made because many commentators were attempting to narrow the definition of "real property" for § 263A(f) by suggesting that the definition should incorporate the relatively expansive notions of tangible personal property developed under the investment tax credit and § 1245. This suggestion, the preamble notes, is contrary to § 263A(f) and its legislative history, which contain nothing to suggest that Congress intended the broad definitions of personal property under former § 48 and § 1245 to apply in the context of interest capitalization.

Specifically, the preamble observes:

> Some commentators interpreted certain language in proposed § 1.263A(f)-1 (relating to the classification of property for purposes of former section 48 and § 1.48-1(c) and § 1.48-1(d)) to provide that property that would otherwise be an inherently permanent structure under section 263A(f) (*i.e.* because it is affixed to real property and

> will ordinarily remain affixed for an indefinite period of time) is not an inherently permanent structure under section 263A(f) if such property would constitute property in the nature of machinery under the principles of section 48 and § 1.48-1(c). 1995-1 C.B. at 22.

To negate this interpretation, the preamble concludes, subparagraph (c)(4)(ii) was added to the final regulations. Although not mentioned in the preamble, the final regulations also omit any reference to § 1.48-1(c) when restating the exclusion of property in the nature of machinery in subparagraph (c)(4)(i), which furthers negates the use and relevance of § 1.48-1(c).

Taken together, the preamble and § 1.263A-8(c)(i) clearly indicate that the definitions of "inherently permanent structures" and "property in the nature of machinery" under § 263A(f) are separate and distinct from the ITC definitions of these terms in § 1.48-1(c). This separation, however, was not intended as a complete rejection of all § 48 authorities bearing on these definitions. Rather, the specific nature of the limitations on the machinery exclusion, added in subparagraph (c)(4)(ii), indicates that the separation was more narrowly intended to reject a specific line of ITC cases and rulings that greatly expanded the definition of what constitutes property in the nature of machinery.

The leading case in this line is Weirick v. Commissioner, 62 T.C. 446 (1974), in which the Tax Court examined disputed claims for investment tax credits on a ski lift. The property at issue included a series of massive ski lift line towers, which were bolted to, or sunk into, massive concrete foundations. Attached to the top of these towers were sets of mechanical "sheave assemblies" that guided the ski lift cables. The towers, the court concluded, were clearly inherently permanent structures, but they qualified as tangible personal property under § 1.48-1(c) because they were also property in the nature of machinery by virtue of their close integration with the sheave assemblies.

The Tax Court pointed to a number of factors indicating the unitary nature of the towers and sheave assemblies. First, a tower and its sheave assemblies were so interrelated in their engineering specifications that they were analyzed and designed as a single unit. Second, the tower and sheaves were so physically interrelated that was often easier and more economical to replace both the tower and the sheaves when the sheaves wore out. Third, the tower and sheaves were "almost inseparable" in terms of the functions they performed. Neither the tower nor the sheaves could perform their shared function of supporting and guiding the lift cable without the other. Finally, the towers served no function independent of supporting the sheave assemblies. Weirick, 62 T.C. at 453-4.

The Tax Court expressly declined to accept taxpayer's theory that the entire ski lift constituted a single giant machine, and thus all of its components qualified as "property in the nature of equipment" because they were merely parts of this machine. The better approach, the court concluded, was to examine each component of the ski

lift separately to determine whether the component was sufficiently integrated with the mechanical operations of the lift to qualify as equipment. Thus, the earthen ramps used to load and unload skiers were examined separately from the towers. The Court concluded that the ramps, unlike the towers, did not qualify as machinery because they were not sufficiently involved in the mechanical operations of the lift. This was true even though the ramps were helpful, or even necessary, for the lift passengers, and thus served an important function in the overall functioning of the taxpayer's hypothetical ski lift "machine."

This reasoning, which constitutes a substantial limitation on the breadth of the Weirick holding, was subsequently used to reject arguments that a walk-in freezer building and a concrete structure providing bays for self-service car wash facilities were property in the nature of machines because they were, in essence, components of a giant freezer and car washer, respectively. Munford, Inc. v. Commissioner, 87 T.C. 463, 488-95 (1986) *aff'd* 849 F.2d 1398 (11th Cir. 1988); Des Moines Cold Storage Co., Inc., v. Commissioner, T.C. Memo. 1988-242; Schrum v. Commissioner, T.C. Memo. 1993-124, *aff'd in part, vacated in part* 33 F.3d 426 (4th Cir. 1994), *on remand* T.C. Memo. 1995-103, *aff'd in part, vacated in part* 111 F.3d 1177 (4th Cir. 1994).

In these cases, the Tax Court applied the factors developed in Weirick and concluded that the structures were not machinery because they were not materially integrated with the mechanical parts of the installations in terms of design, operation or function. The freezer building, for example, served to maintain the proper climate for the freezer chamber by excluding humidity and providing thermal insulation. These functions, however, were independent from the operations of the refrigeration machinery itself, and thus the building and the freezer were not functionally integrated, even though the functions performed by the building were essential for the proper operation of the installation as a hypothetical giant freezer. Munford, 87 T.C. at 492-4.

Weirick was followed by several cases and rulings in which massive property items that clearly qualified as buildings or inherently permanent structures were treated as property in the nature of machinery under § 1.48-1(c) (inherently permanent structures) or § 1.48-1(e)(1) (buildings) because they were sufficiently integrated with machinery. These include:

- A steel tower anchored in concrete was treated as machinery because it was an integral part of an amusement park ride. Marineland of the Pacific, Inc. v. Commissioner, T.C. Memo. 1975-288.

- Enormous "craneway structures" supporting the operations of large overhead cranes in steel mills were property in the nature of machinery rather than "buildings" under § 1.48-1(e)(1). Lukens, Inc. v. Commissioner, T.C. Memo. 1987-464; Barrenechea v. Commissioner, T.C. Memo. 1990-471; Rev. Rul. 79-181, 1979-1 C.B. 41; Rev. Rul. 79-183, 1979-1 C.B. 44.

- Flooring, piers or foundations that supported heavy machinery qualified as part of such machinery. Texas Instruments, Inc. v. Commissioner, T.C. Memo. 1992-306 (concrete floor specially designed to support saws and lappers); Rev. Rul. 79-183, 1979-1 C.B. 44 (concrete foundation and piers supporting stamping press in steel mill); Rev. Rul. 79-182, 1979-1 C.B. 42 (pillars supporting paper making machine).

- Raised flooring and catwalks that allowed access to computers and other equipment for operation and maintenance qualified as section 38 property; catwalks providing access to other portions of the building did not qualify. Rev. Rul. 74-391, 1974-2 C.B. 9.

In sum, Weirick and its related cases stand for the general proposition that inherently permanent structures that support or are otherwise necessary to the operation of machinery are themselves property in the nature of machinery. This is precisely the proposition that is negated by the provisions that were added to the final regulations as subparagraph (c)(4)(ii) of § 1.263A-8. The new material in subparagraph (c)(4)(ii), therefore, must be seen as an acknowledgment and explicit reject of the application of Weirick and similar authorities to the definition of "real property" in section 263A(f).

Although the final regulations clearly reject Weirick, they were not intended to preclude the use of other authority under former section 48 in determining what constitutes “property in the nature of machinery“ under § 1.263A-8(c)(4). Given the specificity of subparagraph (c)(4)(ii), the revisions in the final regulations are focused on rejecting the specific expansion of “property in the nature of machinery“ under Weirick and associated authorities. This conclusion is further supported by the manner in which the final regulations retain the exclusion for “property in the nature of machinery“ in subparagraph (c)(4)(i). The reference to § 1.48-1(c) found in the proposed regulations is omitted, but no independent definition or examples of “property in the nature of machinery“ are supplied. The absence of such guidance suggests that it is proper to consider authorities under former § 48 in determining what constitutes property in the nature of machinery for purposes of § 1.263A-8(c)(4), subject, of course, to the limitations created by the express rejection of *Weirick* in § 1.263A-8(c)(4)(ii).

Section 1.48-1(c) offers several examples of “property in the nature of machinery,“ including gasoline pumps, hydraulic car lifts, and automatic vending machines, which qualify as such even though they are “annexed to the ground.“ None of these examples appear to contradict the rejection of Weirick as expressed in § 1.263A-8(c)(4)(ii), so they should be useful examples for the concept of “property in the nature of machinery“ under § 1.263A-8(c)(4). These items could be informally characterized as self-contained machines that happen to be permanently affixed to the ground; conversely, the properties in the Weirick authorities could be described as inherently permanent structures that become mechanical by intimate association with mechanical devices.

Under the forgoing principles, jacket-type platforms are not property in the nature of equipment or machinery for purposes of § 1.263A-8(c)(4). The function of these platforms is to provide secure support for the property and personnel used in extracting oil and gas. Some of the items of property supported by the platform, such as the rig components, do perform mechanical tasks and are clearly pieces of machinery. The platforms, however, do not perform any mechanical operations in their own right. As such, jacket-type platforms are not comparable to gas pumps, hydraulic lifts, or vending machines (the examples in § 1.48-1(c)) which all perform some physical activity on a self-sufficient basis.

Jacket-type platforms might qualify as property essentially equivalent to a machine for purposes of § 1.48-1(c) under Weirick and related authorities. The platforms provide direct structural support for the mechanical operations of the rig, and as such are closely comparable to the ski lift poles in Weirick, the craneway structures in Lukens, Inc. and Barrenechea, and the piers and foundations supporting papermaking machines in Rev. Ruls. 79-182 and 79-183. In addition, the platforms provide operating personnel with access to the rig machinery that is essential for operation and maintenance, which makes them comparable to the raised flooring and catwalks in Rev. Rul. 74-391.

However, for the reasons discussed above, the possible status of jacket-type platforms as machinery under the Weirick authorities does nothing to establish that such platforms are machinery for purposes of § 1.263A-8(c)(4). Subparagraph (ii) of § 1.263A-8(c)(4) expressly rejects the results in the Weirick authorities by stating that property does not become "property in the nature of machinery" merely because it provides support to machinery and is necessary for its use and operation.

In sum, jacket-type platforms do not constitute "property in the nature of machinery" for purposes of § 1.263A-8(c)(4) because they are not machines in and of themselves; they are merely property that provides support, albeit essential support, to machines.

ISSUE 2: When does the production period for jacket-type platforms begin for purposes of interest capitalization under section 263A(f)?

Section 263A(f)(1)(A) provides that capitalization applies only to those interest costs which are "paid or incurred during the production period." For purposes of this provision, the production period of an item of property is defined in general terms by § 263A(f)(4)(B) to be the period beginning on the date on which production of the property begins and ending on the date on which the property is ready to be placed in service or is ready to be held for sale.

The statutory definition of production period is elaborated in § 1.263A-12, which sets forth rules for determining the beginning and end of the production period for real property and tangible personal property. The statutory definition is further elaborated in § 1.263A-13, which defines the beginning and end of the production period for oil and

gas property. Section 1.263A-13 provides rules that are applied in tandem with the general regulations governing interest capitalization (§§ 1.263A-8 through 1.263A-12, 1.263A-14, 1.263A-15) in capitalizing interest with respect to the development of oil and gas properties as defined by § 1.263A-13.

The provisions of § 1.263A-13 are not applicable to jacket-type platforms because they are not units, or parts of units, of "oil and gas property" for purposes of that regulation. Section 1.263A-13(a) defines oil and gas property to consist of each separate operating mineral interest in oil or gas as defined in § 614(a), or, if a taxpayer makes an election under § 614(b), the aggregate of two or more separate operating interests in oil or gas. Thus, oil and gas property under § 1.263A-13 refers only to interests in the depletable natural resource and does not include other property, such as offshore platforms, that is involved in the extraction of such resources.

Accordingly, a jacket-type platform and the mineral interest which it exploits are distinct units of property for purposes of determining production periods for interest capitalization under § 263A(f). Mineral interests are "oil and gas property" and are subject to the special rules of § 1.263A-13, as well as the general interest capitalization rules under § 263A(f). Jacket-type platforms do not qualify as oil or gas property, and are thus subject only to the general interest capitalization rules in §§ 1.263A-8 through 1.263A-12, 1.263A-14 and 1.263A-15. Thus, the production period of jacket-type platforms is determined under § 1.263A-12 without reference to § 1.263A-13.

Under § 1.263A-12, the production period for self-produced real property begins on the first date that any physical production activity is performed with respect to the property. If the property is produced under contract, the production period for the contractor begins on the date the contractor begins physical production activity, and the production period for the customer begins on the date that either the customer or the contractor begins physical production activity. § 1.263A-12(c)(2).

For purposes of these rules, "physical production activity" is defined by § 1.263A-12(e) to include any physical activity that constitutes production within the meaning of § 1.263A-8(d)(1), which in turn defines production by reference to the definition of such term in § 263A(g) and § 1.263A-2(a)(1)(i). "Produce" is defined in § 263A(g) to include construct, build, install, manufacture, develop or improve. The definition of this term in § 1.263A-2(a)(1) includes the activities listed in § 263A(g) and adds create, raise, and grow to the list.

Section 1.263A-12(e)(2) sets forth a partial list of activities that constitute physical production activity, which includes clearing, grading, or excavating raw land; demolishing or gutting a building; constructing infrastructure, such as roads, sewers, sidewalks, cables and wiring; landscaping; and undertaking structural, mechanical, or electrical activities with respect to a building or other structure. Section 1.263A-12(f) specifically provides that soil testing, preparing architectural blueprints or models, obtaining building permits, and incidental repairs are not considered to be physical production activities.

The production period of self-produced real property ends on the date that the unit is placed in service and all production activities reasonably expected to be undertaken by, or for, the taxpayer or a related person are completed. If the property is produced under contract, the production period for the customer ends when the property is placed in service by the customer and all production activities reasonably expected to be undertaken are complete (i.e., generally no earlier than when the customer takes delivery). § 1.263A-12(d).

It should be noted that § 1.263A-12 defines the beginning of the production period in terms of "physical production activity" (§ 1.263A-12(c)(2)), while the end of the production period is defined in terms of "production activities" (§ 1.263A-12(d)(1)). Thus, the production period for an item of real property can, in the proper circumstances, continue beyond the completion of physical production activities if significant nonphysical production activities remain to be performed. For this purpose, production activities would include those activities falling within the broad definition of "produce" under section 263A(g), § 1.263A-2(a)(1), without application of the limitations in § 1.263A-12(f), which apply only to physical production activities.

"Placed in service" is not separately defined for purposes of § 1.263A-12. In the absence of such definition, it is reasonable to construe this term as having the same meaning as it does for purposes of depreciation, namely that something is placed in service when it is in a condition or state of readiness and availability for a specifically defined function. *See, e.g.,* Rev. Rul. 76-238, 1976-1 C.B. 55; Rev. Rul. 84-23, 1984-1 C.B. 38.

Under the forgoing principles, the production period for a self-produced jacket-type platform begins when physical production activities are first performed with respect to the unit of property. Similarly, the production period for a jacket-type platform produced under contract begins for the customer when physical production activities are first performed with respect to the unit of property, whether by the contractor or the customer.

Many of the activities required to produce a jacket-type platform do not qualify as physical production activities with respect to such unit of property, and the performance of such activities does not commence the production period. Specifically, exploration of the well site, obtaining mineral rights or regulatory approvals, and preparing architectural and engineering specifications are not physical production activities with respect to a jacket-type platform. § 1.263A-12(f).

The first physical production activity performed on a jacket-type platform is typically the construction of the deck and jacket components of the platform. This construction activity corresponds directly to one of the regulatory illustrations of physical production activity with respect to the production of real property, namely the performance of structural and mechanical activities with respect to a structure. § 1.263A-12(e)(2)(iv).

Because of the harsh conditions prevailing at the well site, the construction of the jacket and deck is typically performed at a remote location on shore. However, the construction of a jacket and deck is always directly attributable to the production of a particular jacket-type platform. Jackets and decks are very expensive components, and they must be designed and constructed to suit the unique conditions and demands of a particular well site. Accordingly, fabrication of a deck and jacket is only undertaken in conjunction with the production of a jacket-type platform.

The production period for a self-produced jacket-type platform ends when the unit is placed into service for purposes of depreciation and all production activities reasonably expected to be undertaken by, or for, the taxpayer or a related person are completed. The production period for a platform produced under contract ends for the customer when the property is placed in service for purposes of depreciation and all production activities reasonably expected to be undertaken are complete, which is generally no earlier than when the customer accepts delivery.

The close of a production period is defined by reference to the end of all production activities, not merely physical production activities. Thus, if expected nonphysical activities remain to be performed after physical construction is completed, such as inspections or approvals, then the production period does not close until such activities are completed.

We trust that this will be of assistance to you. If you have any questions, please contact _____ of my office at (202) 622-4970.